

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Coto Analyst: Rachel Coco Bill Number: AB 1403
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 22, 2005
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Tax Rates/Increase To 10% & 11%/AMT To 8.5%

SUMMARY

This bill would increase the top personal income tax (PIT) rates to 10% and 11% and would increase the alternative minimum tax (AMT) rate to 8.5%.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to protect funding for education by increasing general fund revenues.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2006.

POSITION

Pending.

Summary of Suggested Amendments

Amendment 1 is provided to make a technical correction.

ANALYSIS

FEDERAL/STATE LAW

Federal law imposes five different income tax rates on individuals ranging from 10% to 35%. Existing state law imposes six different PIT rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index (CPI).

Federal law provides a personal income AMT rate of 26%. Existing state law provides a personal income AMT rate of 7%. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	<u> X </u> PENDING

Department Director

Date

Gerald H. Goldberg

3/24/05

Proposition 63 was approved by voters in the November 2004 General Election and provides a dedicated funding source for the expansion of mental health treatment options for children, adults, and seniors as follows:

- Starting with the 2005 taxable year, it imposes an additional 1% tax, not subject to reduction by credits, on the portion of a taxpayer's taxable income that exceeds \$1 million.
- The estimated revenue from the additional 1% tax is deposited into the Mental Health Services fund on a monthly basis, subject to an annual adjustment.

THIS BILL

This bill would establish a PIT rate of 10% for:

- Single filers (including married filing separate) whose taxable income is over \$146,289 and equal to or less than \$292,578,
- Joint filers whose taxable income is over \$292,578 and equal to or less than \$585,156, and
- Head of household filers whose taxable income is over \$199,121 and equal to or less than \$398,243.

This bill would establish a PIT rate of 11% for:

- Single filers (including married filing separate) whose taxable income is over \$292,578,
- Joint filers whose taxable income is over \$585,156, and
- Head of household filers whose taxable income is over \$398,243.

For example:

Actual 2004 Tax Brackets And Rates For Single Filers

\$0	-	\$6,147	1.0%
\$6,147	-	\$14,571	2.0%
\$14,574	-	\$22,997	4.0%
\$22,997	-	\$31,925	6.0%
\$31,925	-	\$40,346	8.0%
\$40,346	-	And Over	9.3%

Projected 2006 Tax Brackets And Rates For Single Filers As Proposed

\$0	-	\$6,427	1.0%
\$6,427	-	\$15,234	2.0%
\$15,234	-	\$24,043	4.0%
\$24,043	-	\$33,377	6.0%
\$33,377	-	\$42,182	8.0%
\$42,182	-	\$146,289	9.3%
\$146,289	-	\$292,578	10%
\$292,578	-	\$1 Million	11%
\$1 Million	-	And over	12%

Note: The actual 2006 tax bracket amounts are not known at this time due to the annual indexing adjustment, which is based on data that is not available until the end of June 2005. As a result, the 2006 threshold amounts discussed above are only projections.

This bill provides that the 10% and 11% brackets would be adjusted annually for inflation.

This bill also would increase the AMT rate to 8.5% for individual taxpayers.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill could be accomplished during the department's normal annual updates.

TECHNICAL CONCERN

This bill provides that a 10% tax rate shall apply to amounts over \$100,000. The author's staff has indicated that the amount should instead be \$136,115. An amendment has been provided to make the correction.

LEGISLATIVE HISTORY

AB 6 (Chan, 2005) contains language similar to the language of this bill, but also would reduce the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63. AB 6 is currently in the Assembly Revenue and Taxation Committee.

AB 4 (Chan, 2003) and SB 1255 (Burton, 2002) contained language similar to the language of this bill. Both bills failed to pass out of the house of origin by the constitutional deadline.

SB 169 (Alquist, Stats. 1991, Ch. 117) increased the tax rates on individuals for taxable years beginning on or after January 1, 1991, and before January 1, 1996, by adding 10% and 11% brackets and increasing the AMT rate from 7% to 8.5%.

PROGRAM BACKGROUND

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase in 1991, adding 10% and 11% rates for the highest income taxpayers. This temporary tax increase was in effect for four taxable years and sunset for taxable years beginning on or after January 1, 1996.

OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax. *Illinois*, *Massachusetts*, and *Michigan* impose a flat tax of 3%, 3.95%, and 5.3%, respectively. *Minnesota* has a progressive rate with a maximum tax bracket of \$63,860 and a maximum tax rate of 7.85%. These amounts and rates apply to returns filed in 2005 for the 2004 taxable year.

New York recently added two additional tax rates, which increased the maximum rate from 6.85% to 7.5% and 7.7%. These additional tax rates are effective for taxable years 2003 through 2005. For taxable years beginning after 2005, the rates will revert back to a maximum of 6.85%.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Estimated Revenue Impact of AB 1403 Effective On Or After January 1, 2006, With Enactment Assumed After June 30, 2005 (\$ Billions)			
Fiscal Year	2005-06	2006-07	2007-08
	+\$1.2	+\$2.6	+\$2.8

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The above estimate is based on the department's personal income tax model. This estimate should be considered preliminary because an updated income tax model is not yet available. This bill is estimated to impact approximately 390,000 taxpayers.

LEGISLATIVE STAFF CONTACT

Rachel Coco
Franchise Tax Board
845-4328
rachel.coco@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov

Analyst	Rachel Coco
Telephone #	845-4328
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1403
As Introduced February 22, 2005

AMENDMENT 1

On page 4, line 19, strike out "one hundred thousand dollars (\$100,000)" and insert:

one hundred thirty-six thousand one hundred fifteen dollars (\$136,115)